

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

JOINT LOGISTICS SYSTEMS CENTER'S
FINANCIAL STATEMENTS FOR FY 1993

Report No. 94-147

June 24, 1994

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Department of Defense

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Acronyms

DBOF
JLSC

Defense Business Operations Fund
Joint Logistics Systems Center



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

June 24, 1994

MEMORANDUM FOR SECRETARY OF DEFENSE
COMPTROLLER AND CHIEF FINANCIAL OFFICER OF THE
DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
COMMANDER, JOINT LOGISTICS SYSTEMS CENTER

SUBJECT: Audit Report on the Joint Logistics Systems Center's Financial Statements for
FY 1993 (Report No. 94-147)

We are providing this report for your information and use, and for use by Congress. Financial statement audits are required by the Chief Financial Officers Act of 1990. We reviewed the fairness of financial statements and the adequacy of internal controls and compliance with laws and regulations. Comments on a draft of this report were considered in preparing the final report.

We are disclaiming an opinion on the FY 1993 financial statements because the accounting systems in place, as recognized by the Joint Logistics Systems Center in its management representation letter, were not adequate to provide the needed information to prepare the financial statements. Additionally, significant deficiencies in the internal control structure and noncompliance with required laws and regulations added to our inability to express an opinion. The recommendations in our audit report addressing the Internal Management Control Program and financial management procedures would also apply to a Joint Logistics Systems Center successor organization.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Commander, Joint Logistics Systems Center, must provide comments on the unresolved recommendations by August 23, 1994. Those comments should indicate either concurrence or nonconcurrence with each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements.

The courtesies extended to the audit staff are appreciated. If you have any questions about this audit report, please contact Mr. Charles Hoeger, Audit Program Director, in our Philadelphia Office, at (215) 737-3881 (DSN 444-3881) or Mr. John Issel, Audit Project Manager, in our Columbus Office, at (614) 337-8009. The distribution of this report is in Part V, Appendix B. The audit team members are listed on the inside back cover.

A handwritten signature in cursive script, reading "Robert J. Lieberman", is positioned above the typed name.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 94-147
(Project No. 2LD-2021)

June 24, 1994

FINANCIAL STATEMENTS OF THE JOINT LOGISTICS SYSTEMS
CENTER FOR FY 1993

EXECUTIVE SUMMARY

Introduction. The Chief Financial Officers Act of 1990 requires the annual preparation and audit of financial statements for revolving fund activities, such as the Joint Logistics Systems Center (JLSC), a corporate business area within the Defense Business Operations Fund. The JLSC was created on February 11, 1992, to implement integrated logistics business process improvements through management of the design, development, integration, implementation and maintenance of the logistics areas of the corporate information management effort. The JLSC operates under the authority and direction of the Deputy Under Secretary of Defense for Logistics. In March 1994, the Deputy Under Secretary of Defense for Logistics proposed disestablishing JLSC and establishing a Logistics Standard Systems Joint Program Office to manage the depot maintenance and materiel management programs.

Objectives, Scope and Methodology. The initial audit objectives were to determine whether the FY 1993 financial statements for the JLSC were presented fairly in accordance with generally accepted accounting principles for Federal agencies. Based on our survey, we concluded that we could not provide an opinion on JLSC's financial statements as a whole and we revised our objectives to address the reasonableness of JLSC's property, plant, and equipment account and its use of and control over resources provided in its capital and operating budgets and the effect on the financial statements.

Our examination concentrated on the \$266.4 million reported for the property, plant, and equipment account because the account represented 99.8 percent of JLSC's positive asset balances and 94 percent of JLSC's expended funds.

We also evaluated the adequacy of JLSC's internal control structure, assessed compliance with laws and regulations that could have a material effect on the financial statements, and evaluated the usefulness of the information presented in the financial statements.

The Joint Logistics Systems Center's FY 1993 financial statements were received by the Inspector General, DoD, on March 15, 1994.

Independent Auditor's Opinion. We are disclaiming an opinion on the FY 1993 financial statements because the accounting systems in place, as recognized by the Joint Logistics Systems Center in its management representation letter, were not adequate to provide the needed information to prepare the financial statements. Additionally, significant deficiencies in the internal control structure and noncompliance with required laws and regulations added to our inability to express an opinion.

Internal Controls. Part II contains our report on internal controls. We identified material internal control weaknesses in that controls were not established to provide reasonable assurance that material misstatements in the financial records and statements

would be prevented or detected in a timely manner. Additionally, JLSC did not ensure that project expenditures of its funds by central design activities were recorded in an accurate and timely manner.

Compliance With Laws and Regulations. Part III contains our report on compliance with laws and regulations. The Joint Logistics Systems Center was not in compliance with DoD guidance on capitalization of assets and use of operating budget funds. The laws and regulations tested are listed in Part III.

Usefulness of the Financial Statements. Because JLSC's financial statements did not accurately portray its financial position, material inaccuracies in financial data were reported to higher authority and the usefulness of the financial statements was limited.

Recommendations. The draft audit report recommended that JLSC establish an Internal Management Control Program; capitalize all applicable capital assets and disclose the extent of no cost usage for facilities and services; discontinue the use of operating budget funds on capital projects; and establish controls to ensure that capital expenditures are reported monthly and that yearend closeout procedures are effective.

Management Comments. JLSC generally concurred with our recommendations and stated that it was working with the Defense Finance and Accounting Service to correct deficiencies. However, JLSC did not agree with the need to capitalize applicable assets in accordance with established criteria. The Defense Finance and Accounting Service comments were responsive. Management comments are included in their entirety in Part IV of this report.

Audit Response. JLSC's comments to two recommendations were only partially responsive. Therefore, JLSC is requested to provide comments to the final report by August 23, 1994.

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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

**Part I - Independent Auditor's Opinion
on the Financial Statements**

Introduction

The Joint Logistics Systems Center (JLSC) was created as a corporate business area of the Defense Business Operations Fund (DBOF) on February 11, 1992. JLSC's charter was to coordinate the development of software programs for the areas of depot maintenance and supply management. Its mission entailed the achievement of corporate information management goals for the DoD logistics business areas, that is, depot maintenance and supply management, by managing the design, development, and implementation of improved business systems. JLSC is located at Wright-Patterson Air Force Base, Dayton, Ohio, and has about 250 people assigned. Also, about 70 contractor personnel perform work at JLSC. In March 1994, the Deputy Under Secretary of Defense for Logistics proposed disestablishing JLSC and establishing a Logistics Standard Systems Joint Program Office to manage the depot maintenance and materiel management programs.

JLSC operates under the authority and direction of the Deputy Under Secretary of Defense for Logistics and is provided technical and functional oversight by the Assistant Secretary of Defense (Command, Control, Communication, and Intelligence). The Comptroller of the DoD provides JLSC an annual operating budget funded through the DBOF cash corpus. The annual operating budget includes both a capital and an operating budget. The capital budget is used for capital projects, primarily for the costs of systems development in the depot maintenance and supply management areas. The operating budget is intended to cover the normal administration or operating costs of the JLSC. JLSC executes its mission of systems development primarily by issuing reimbursable orders to DoD systems design centers. Upon completion of a functional program, the capitalized system will be transferred to the using DoD components, and costs recovered through depreciation charges to system users.

The Chief Financial Officers Act of 1990 (Public Law 101-576) requires an annual audit of funds such as the JLSC. The Defense Finance and Accounting Service, Denver Center, provides financial services and prepares the financial statements for JLSC. The Defense Finance and Accounting Service, Denver Center, relies on the Defense Accounting Office at Wright-Patterson Air Force Base for inputs to the financial accounting system. Personnel at JLSC submit accounting data to the Defense Accounting Office, which in turn performs the financial system data entry, certifies funds, and processes collections and payments on behalf of JLSC. JLSC's financial statements are prepared by the Defense Finance and Accounting Service, Denver Center, based on information provided by the Defense Accounting Office and JLSC. However, the ultimate responsibility for the accuracy of the data in the statements belongs to JLSC. Our responsibility is to express an opinion on those statements based on our examination.

Scope and Methodology

We examined the Principal Statements and the Notes to the Principal Statements of the Joint Logistics Systems Center as of and for the year ended September 30, 1993. The Principal Statements include the Statement of Financial Position, Statement of Operations, Statement of Cash Flows, and Statement of Budget and Actual Expenses. Also included are the Footnotes, Overview, and Supplemental Information.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, including the accompanying notes. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our audit included an assessment of the reasonableness of JLSC's financial data reflected in both the FY 1992 and FY 1993 financial statements. We evaluated the procedures and controls that JLSC and the Defense Finance and Accounting Service, Denver Center, used to prepare the FY 1992 financial statements because the FY 1992 ending balances represented FY 1993 opening balances for JLSC's asset, liability and equity accounts. Also, since JLSC was established in FY 1992 and its first full year of operation was FY 1993, we concentrated our review on JLSC's use of and control over resources provided to it in its capital and operating budgets and the effect of JLSC's funds control procedures on its financial statements. We believe that our audit efforts provide a reasonable basis for our results.

This financial statement audit was made from September 1992 through March 1994. The audit entailed the use of computer-processed financial data and reports. We determined the reliability of the computer-processed data as related to the property, plant, and equipment account. Organizations visited or contacted are in Part V, Appendix A.

Auditing Standards

We conducted our audit in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements.

Accounting Principles

Accounting principles are currently being studied by the Federal Accounting Standards Advisory Board (the Board). Generally accepted accounting principles for Federal entities are to be promulgated by the Comptroller General

Independent Auditor's Opinion on the Financial Statements

of the United States; the Director, Office of Management and Budget; and the Department of the Treasury, based on advice from the Board. In the interim, Federal agencies are to follow the applicable accounting standards contained in agency accounting policy, procedures manuals, and related guidance. The summary of significant accounting policies included in the Notes to the Principal Statements describes the accounting principles and methods of applying those principles that management has concluded are the most appropriate for presenting the JLSC's significant assets, liabilities, net position, results of operations, cash flows, and reconciliation to the budget.

Disclaimer of Opinion

We are disclaiming an opinion on the FY 1993 financial statements because the accounting systems in place, as recognized by JLSC in its management representation letter, were not adequate to provide the needed information to prepare the financial statements. Additionally, significant deficiencies in the internal control structure and noncompliance with required laws and regulations added to our inability to express an opinion (See Parts II and III for details).

Additional Information

We reviewed the financial information provided in the Overview to the JLSC's FY 1993 financial statements. Such information has not been audited by us; accordingly, we do not express an opinion on that information.

Since the inception of JLSC in FY 1992, the Inspector General, DoD, has issued two financial related audits concerning JLSC. The audits are summarized below.

The Inspector General, DoD, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993, stated that the addition of JLSC to the DBOF was in violation of the National Defense Authorization Act for FYs 1992 and 1993. Section 316 of the Defense Authorization Act prohibits the addition of other functions, activities, funds, or accounts of the DoD to the DBOF. The Acting Chief Financial Officer of the DoD disagreed and stated that JLSC did not represent new functions, activities, funds, or accounts; but rather, was a reorganization of activities already within the DBOF. The final decision was to retain JLSC in the DBOF.

The Inspector General, DoD, Report No. 94-132, "Naval Design Activities' Management of Costs on Joint Logistics Systems Center's Orders," June 14, 1994, reported that Navy design activities continued to perform work for customers, including JLSC, that exceeded available customer funding, contrary to DoD and Navy regulations. Design activities of three major Navy commands incurred overruns of about \$1.6 million on reimbursable orders issued by JLSC. The Naval Audit Service reported similar conditions at a

Independent Auditor's Opinion on the Financial Statements

number of those activities in June 1987 and again in March 1992. We recommended that Navy management officials review cost overrun reports to determine the full extent of customer overruns at its activities and take appropriate action against personnel in continued noncompliance with Navy direction.

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Part II - Internal Controls

Internal Controls

Introduction

We examined the internal control structure of JLSC for the year ended September 30, 1993. Management of JLSC is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that the following are met.

- o Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.

- o Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

- o Transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the consolidating statements, and any other laws and regulations that the Office of Management and Budget, entity management, or the Inspector General, Department of Defense, has identified as being significant for which compliance can be objectively measured and evaluated.

- o Data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because FY 1993 was JLSC's first full year of operation, performance measures had not yet been established.

Objectives

The objective of the audit was to determine whether material internal control weaknesses existed. Specifically, we determined whether the internal control structure was established to ensure that the financial statements were free of material misstatements. We considered the internal control structure in determining audit procedures that were needed in order to express an opinion on the financial statements. We reviewed JLSC's implementation of the DoD Internal Management Control Program. Our review included an evaluation of JLSC's policies and procedures for capitalizing and reporting financial data on its property, plant, and equipment accounts; compliance with applicable laws and regulations; and use of funds provided in its capital and operating budgets.

We conducted our audit in accordance with generally accepted auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and Office of

Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Statements are free of material misstatements.

Results of Audit

Reportable Conditions. Internal control weaknesses existed that we consider to be material and reportable under standards established by Office of Management and Budget Bulletin No. 93-06. Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgement, could adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance. A material weakness is a reportable condition in which the design or operation of the internal control structure does not reduce to a relatively low level the risk that errors or irregularities could occur. Such errors would be in amounts that would be material to the statements being audited, or material to a performance measure or aggregation of related performance measures, and not be detected within a timely period by employees in the normal course of performing their functions. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

The JLSC financial statements did not accurately reflect its financial position. Specifically, the property, plant, and equipment balance of \$266.4 million and operating expenses of \$29.6 million for FY 1993 were materially misstated. We attributed the inaccuracies to the lack of an effective internal control program, as required by DoD guidance, and weaknesses in controls over monthly capital expense reporting.

Internal Management Control Program. JLSC's failure to establish an internal management control program, as required by Office of Management and Budget and DoD guidance, contributed to the lack of controls to ensure accurate and timely financial data. JLSC had not designated an internal management control coordinator, identified assessable units, performed risk assessments of its units, developed a management control plan, conducted management control reviews, and identified and taken corrective actions on control weaknesses. Consequently, JLSC's procedures did not readily detect and correct errors in its financial reports. We attribute the inaccuracies to noncompliance with OMB and DoD guidance and nonenforcement of JLSC guidance.

Controls Over Expense Reporting. JLSC did not enforce its requirement that expenses incurred by other activities on JLSC projects be promptly reported. JLSC's "Financial Management Procedures Handbook," July 1992, requires that central design activities performing work for JLSC report, in accordance

Internal Controls

with DBOF revenue recognition policies, on a monthly basis expenditures made on behalf of JLSC projects. The requirement for monthly reporting of expenses incurred is reiterated on each reimbursable order issued by JLSC to the design activities. As a result of inadequate reporting, the JLSC financial statements are inaccurate and the usefulness of the statements is limited.

To illustrate, JLSC's Statement of Financial Position for FY 1993 reported \$266.4 million for property, plant, and equipment. Footnote I to the FY 1993 Financial Statements states that the \$266.4 million consists of all software development costs incurred on JLSC capital projects. The \$266.4 million includes \$16.4 million incurred in FY 1992 and \$250 million incurred in FY 1993. However, the software development costs reported have been significantly understated. For example, in response to our inquiries, 64 design activities told us that they had incurred expenses of over \$140 million during FY 1992 on JLSC projects, versus the \$16.4 million reported by JLSC for FY 1992. We were not able to verify the extent of the design activities' expenditures for FY 1993 because of the time required to verify expenditures at all activities performing work for JLSC and the congressionally mandated requirement to have our report to the DoD Chief Financial Officer by June 30, 1994.

The usefulness of the financial statements for comparative purposes was limited because of the underreporting of software development costs, as reflected in the property, plant, and equipment accounts. The FY 1992 statements underreported software development costs by at least \$123.6 million (\$140 million minus \$16.4 million) and the reported FY 1992 asset balance was not corrected for the comparative financial statements prepared for FY 1993. As discussed above, the extent of underreporting for FY 1993 is unknown, but we believe it is also material because JLSC had not established effective controls for monthly expense reporting and yearend closeout procedures.

Management Comments

Comments from the JLSC Acting Director of Resource Management to the draft report were responsive. In response to our recommendation to establish an Internal Management Control Program, JLSC concurred and stated that it was working with the Defense Finance and Accounting Service to establish an internal control program within 1 year.

JLSC nonconcurred with our recommendation to establish controls to ensure that expenditures by other activities on JLSC projects are reported monthly and to establish effective yearend closeout procedures to ensure that all project expenditures are accurately reflected in financial statements. However, JLSC stated it had sent numerous letters to both central design activities and to the Defense Finance and Accounting Service describing the requirement to capture the costs as developments occur. JLSC has briefed the Comptroller of the DoD on that problem several times and is receiving preliminary billing

information on all bills processed through the Defense Finance and Accounting Service, Columbus Center. Management comments are included in their entirety in Part IV of this report.

Audit Evaluation of Management Comments

Even though JLSC nonconcurred with our recommendation the actions taken are acceptable and meet the intent of the recommendation.

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Part III - Compliance With Laws and Regulations

Introduction

We evaluated JLSC for material instances of noncompliance with laws and regulations for the year ended September 30, 1993. Such tests are required by the Chief Financial Officers Act of 1990. The laws and regulations are listed below.

Objectives

The objective of the audit was to determine whether material instances of noncompliance with laws and regulations existed. Material instances of noncompliance are failures to follow requirements of, or violations of prohibitions contained in laws and regulations. Such failures or violations are those that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Principal Statements, or those whose sensitive nature would cause them to be perceived as significant by others.

Compliance with laws and regulations applicable to the JLSC is the responsibility of JLSC managers. To ensure that the JLSC Principal Statements were free of material misstatements, we tested compliance with laws and regulations that may directly affect the financial statements and certain other laws and regulations designated by the Office of Management and Budget and the DoD. The laws and regulations tested were:

- o Federal Managers' Financial Integrity Act of 1982
- o Chief Financial Officers Act of 1990
- o Office of Management and Budget Bulletin No. 93-02, "Guidance on Form and Content of Agency Financial Statements," October 22, 1992
- o Office of Management and Budget Circular No. A-123, "Internal Control Systems," August 4, 1986
- o "DoD Guidance on Form and Content of Financial Statements for FY 1993/FY 1994 Financial Activity," January 12, 1993
- o DoD Manual 7220.9-M, "DoD Accounting Manual," October 1983
- o DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987
- o DoD Directive 7200.1, "Administrative Control of Appropriations," Revised July 27, 1987

As part of our audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Manager's Financial Integrity Act (FMFIA) and the DoD Internal Management Control Program. We also reviewed and tested the entity's policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the Overview to JLSC's Principal Statements. However, our objective was not to provide an opinion on overall compliance with such provisions.

We conducted our audit in accordance with generally accepted Government auditing standards, issued by the Comptroller General of the United States as implemented by the Inspector General, Department of Defense, and Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. Those standards require that we plan and perform the audit to obtain reasonable assurance that the JLSC Principal Statements are free of material misstatements.

Results of Audit

Our audit disclosed several instances of noncompliance with laws and regulations that materially affected the reliability of the JLSC Principal Statements. In addition to JLSC's noncompliance with Office of Management and Budget and DoD requirements on establishment of an Internal Management Control Program, as discussed in Part II, Internal Controls, JLSC was in noncompliance with DoD criteria on asset capitalization and use of operating budget funds. Details on JLSC's noncompliance are presented in the following paragraphs.

Capitalization of Assets. DoD criteria for capitalizing assets is contained in instructions issued by the Comptroller of the DoD, "Capital Asset Accounting Guidance for Defense Business Operations Fund," July 21, 1992. JLSC did not comply with Comptroller of the DoD guidance on capitalization of assets. The only assets reflected in JLSC's property, plant, and equipment account were expenditures made by JLSC from its capital budget to reimburse central design activities for development of software programs. However, our review of JLSC's use of its operating budget showed that in FYs 1992 and 1993 about \$4.7 million (23 percent) and \$6.7 million (18 percent), respectively, were invested in capital assets such as computers, work stations, and software programs. The investments were inappropriately expensed in the fiscal year operations and not reflected on the property, plant, and equipment account. Assets purchased in both FY 1992 and FY 1993 met the criteria for capitalization.

After we discussed the noncapitalization of assets with JLSC's management, it acknowledged the following in the Management Representation Letter accompanying the FY 1993 financial statements.

Compliance With Laws and Regulations

In retrospect, its equipment items with values greater than \$25,000 probably should have been capitalized and appropriately depreciated over five years. We believe, however, that the amounts were immaterial enough in relationship to our capital program that they could just as easily be expensed in both FY 1992 and FY 1993. In contrast, all of our (capital program) system developments, including the aforementioned equipment items which were expensed, will be capitalized by the components when deployed and depreciated over a useful life of five years.

While management's acknowledgment of its failure to appropriately capitalize assets is a step in the right direction, action should still be taken to capitalize assets in accordance with guidance. Additionally, the guidance for FY 1993 and prior years required the capitalization of assets valued at over \$15,000 with a 2-year useful life, rather than \$25,000 as stated above.

The Comptroller of the DoD guidance also requires that DBOF activities capitalize and reflect on financial statements the value of real property assets for which they can substantiate preponderant use in the production of goods or services for its customers. The Air Force provided the JLSC, at no cost, substantial facilities and numerous services, such as contracting services. The use of Air Force facilities and services should, at a minimum, be disclosed in footnotes to the financial statements, to enable users of the statements to assess the effect of the free services on JLSC operations.

Use of Operating Funds on Capital Projects. JLSC also did not comply with Comptroller of the DoD guidance on the use of operating budget funds. The Comptroller directed that all capital projects be funded through the capital budget provided to JLSC. However, about \$820,000 in FY 1993 operating funds were used for several capital projects, not capitalized, and inappropriately expensed in current year operations. For example, JLSC approved the expenditure of about \$300,000 to a contractor for an assessment of candidate ammunition and logistics management systems in support of the DoD Ammunition Migration System. The Ammunition Migration System is an approved capital budget project funded at \$16.1 million in the capital budget.

Comptroller of the DoD procedures provide for project costs being capitalized at completion, transferred to the using DoD Components, and recovered by the DBOF by charging the ultimate users for depreciation of the project. As such, it is essential that JLSC maintains an accurate accounting of costs of individual projects and uses only appropriate funds.

Management Comments

The Defense Finance and Accounting Service's comments were responsive. However, JLSC's comments were only partially responsive. The comments are summarized below and included in their entirety in Part IV of this report.

JLSC nonconcurred with our recommendation to capitalize all applicable capital assets in accordance with established criteria, and stated that it was cognizant of the DoD accounting policy for capital assets. It was given operating budget funds for equipment purchases and believed that any costs benefiting only JLSC would be funded from the operating budget and therefore, expensed. JLSC believed that treating equipment as capital assets would result in double expensing of equipment depreciation by both the JLSC and the DoD Components.

JLSC concurred with our recommendation to disclose the extent of no-cost usage for facilities and services, and stated that in future years, financial statement footnotes would disclose that information.

JLSC concurred with the recommendation to discontinue the use of operating budget funds on capital projects and to ensure that costs incurred in the past are appropriately included in the capital project costs.

JLSC disagreed with our recommendation to revise the FY 1993 Financial Statements to show the effect of capitalizing assets and, at a minimum, disclose in the footnotes to the revised statements the problems identified by the audit. It stated that the \$10 million in asset acquisitions was minimal in relation to JLSC's total budget; therefore, it did not believe that restating the financial statements was warranted. The Defense Finance and Accounting Service responded that it concurred, in principle; but that because neither the audit report nor management response to the audit was finalized before publication of the FY 1993 financial statements, disclosure of the problems identified by the audit could not be included. Any changes agreed to by JLSC will be incorporated in the FY 1994 statements.

Audit Evaluation of Management Comments

The issue of whether a capital asset is purchased with operating budget funds or capital budget funds is not germane to the issue of capitalizing assets that meet the DoD criteria for capitalization. JLSC's capital assets provide benefits over more than a 2-year period. Therefore, to ensure that appropriate costs of systems development are transferred to the DoD Components and ultimately recovered by the component through charges to systems users, the assets should be capitalized in accordance with DoD guidance and generally accepted accounting principles.

Although JLSC concurred with the recommendation on discontinuing the use of operating budget funds on capital projects and ensuring that costs incurred in the past are appropriately included in the capital project costs, it did not provide comments on the actions that have or will be taken and the date of implementation of the corrective actions. We request that JLSC provide its planned actions and implementation dates.

Compliance With Laws and Regulations

The Defense Finance and Accounting Service and JLSC response on disclosing the problems identified by the audit and the extent of no-cost usage of facilities and services in the FY 1994 financial statements rather than revising the FY 1993 statements is acceptable because the FY 1993 statements have already been published. We request that JLSC reconsider its comments to capitalizing applicable assets in accordance with DoD guidance.

Part IV - Management Comments

Joint Logistics Systems Center Comments



JOINT LOGISTICS SYSTEMS CENTER
WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433

MEMORANDUM FOR DOD-IG/AIG (MR. TERRY ROHR)
555 OFFICENTER PLACE, SUITE 115
GAHANNA OH 43230-5337

1 MAY 1994

FROM: JLSC/RM
Building 15
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

SUBJECT: Draft Audit Report on the Joint Logistics Systems Center's (JLSC) Financial
Statements for FY93 (Project No. 2LD-2021) - INFORMATION MEMORANDUM

1. We have reviewed your proposed audit report and have the following responses to your recommendations:

a. Recommendation: JLSC establish an Internal Management Control Program.

Concur: In our first two years of operation, we immediately "hit the ground running" and have not yet implemented all necessary financial programs, including those relating to the Federal Managers Financial Integrity Act of 1982. We are currently working with DFAS to establish an internal control program. We believe, however, to meet this requirement, it may require an increase in JLSC manning or require services from DFAS at a negotiated cost to us. With the proper manning, we believe we could have a sound, internal management control program implemented within one years time.

b. Recommendation: JLSC should capitalize all applicable capital assets in accordance with established criteria.

Nonconcur: We are cognizant of DBOF accounting policy, July 1992, and fully understand that all capital assets acquired or developed with useful life of two years or more, capital value in excess of \$15,000 (\$25,000 in FY94), and budgeted for in the capital budget should be appropriately depreciated rather than expensed. JLSC, however, was given operating budget for equipment and not capital. We have always operated with the belief that any costs benefiting only JLSC would be funded from the operating budget and accordingly expensed. (Ultimately, when our developed AIS systems are fielded all development costs, including JLSC operating costs, will be depreciated by the receiving Component.) We believe that our treating of equipment as capital assets may result in double expensing of equipment depreciation by both the JLSC as well as the Components. This is a subset of our questions concerning depreciation of AIS within DBOF, we have forwarded that to DOD(C). We have not received responses regarding these concerns.

We made a conscious decision with the approval of DOD(C) to treat our relatively small equipment purchases as part of operations and accordingly expensed for operations. We believe this to be appropriate, in keeping with the accounting principle of materiality. Our equipment acquisitions over two years represents about \$10 million in relation to a total budget over that period of \$600 million, or less than 2%. Because of the relatively small amount and impact on our financial statements, we do not believe that restating our prior financial statements are warranted.

c. Recommendation: JLSC should disclose the extent of no cost usage for facilities and services.

Concur: For future years, we will provide footnotes to explain that we are given use of an Air Force facility at Wright-Patterson AFB, having only to cover Base Operating Support costs.

d. Recommendation: Discontinue the use of operating budget funds on capital projects and ensure costs incurred in the past are appropriately included in the capital project costs.

Concur.

e. Recommendation: Establish controls to ensure expenditures by other activities on its projects are reported monthly and establish effective year-end close-out procedures to ensure all project expenditures are accurately reflected in financial statements.

Nonconcur: JLSC has sent numerous letters to both the developing activities and DFAS describing the requirement to capture incurred costs (billings) as development takes place (attachment). We have also briefed DOD(C), including Mr. Keavy, Chief Financial Officer, on the issue several times. This is currently a DFAS issue, only recently has DFAS-Columbus agreed to send us preliminary bills. In the last two months we have made great progress and are now getting preliminary billings information on all bills processed through DFAS-Columbus (about 70% of our funds). For projects billed through other DFAS sites, we have not yet determined a conclusive resolution. With DFAS as the lead on this problem, we hope to come to closure on this issue within the next fiscal year. Finally, during preparation of the FY93 Financial Statements, we worked with DFAS-Denver to establish procedures to ensure inclusion of all project expenditures at year-end by way of an estimated accrual for any billings which had not yet cleared through DFAS-Denver.

2. Our point of contact is Dennis Kahn, JLSC/RMF, DSN 785-0405.



SHERRY PARTEE
Acting Director
Resource Management

Attachment
Letters to JLSC MIPR Recipients



(Accounting)

DEFENSE FINANCE AND ACCOUNTING SERVICE

WASHINGTON, DC 20376-5001

SEP 29 1993

MEMORANDUM FOR DISTRIBUTION

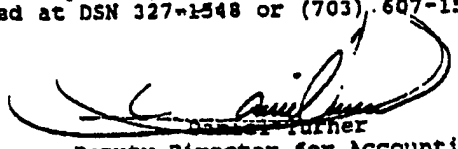
SUBJECT: Joint Logistics System Center (JLSC) Capital Budget
MIPR Billings

By Office of the Secretary of Defense direction, all information system and business process initiatives for supply management and depot maintenance business areas, including those related to Computer Aided Acquisition Logistics Support, are to be funded through the Capital Budget of the JLSC.

To maintain program execution visibility, JLSC must maintain separate sub-accounts for each line item in the Capital Budget and accumulate costs by budget line item and project. JLSC is currently experiencing unacceptable delays in obtaining billing information when MIPR billings are processed under cross-disbursing procedures. JLSC has requested that activities bill them for all costs incurred by SF 1080 procedure.

Although we cannot mandate the use of SF 1080 procedures, we propose use of an alternative method. For activities using cross-disbursing procedures, we recommend pre-billings be forwarded to JLSC. Under this arrangement, timely cost data is provided to JLSC. The pre-billings, as a minimum, should provide details on the deliverables being billed.

Mr. David Moy is my point of contact for this project, and can be reached at DSN 327-1548 or (703) 607-1548.


Robert Turner
Deputy Director for Accounting

01 JUL 1993

FROM: JLSC/RM
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

SUBJ: Billing of FY93 Costs Incurred on JLSC Capital Budget Military Interdepartmental
Purchase Requests (MIPRs)

TO: Distribution List

1. In our 7 Jul 92 and 8 Sep 92 letters to you, we noted that we had received no billings on MIPRs issued by JLSC for Automated Information Systems (AIS) projects under our purview. While we did receive billings from most of your activities after our 8 Sep 92 letter, we have not received any billings for costs incurred in FY93. The 21 Jan 92 DOD(C) Revenue Recognition policy letter (attached) states "The percentage of completion method of revenue recognition shall be used for all end-product type orders that are expected to be completed in a fiscal year other than the fiscal year in which the order is started." Further, the customer funding the order (in this case, the JLSC) shall be billed for revenue recognized at the end of each quarter at a minimum.

2. It is imperative that these billings be received in order to ensure that earnings are properly credited to your organization. A lack of recorded earnings gives the impression that no progress is being made in the development and implementation of Logistics CIM projects. It will be very difficult to defend future capital investment requirements in budget preparation drills if we cannot show execution of current programs.

3. On MIPRs where effort has continued in FY93, we encourage you to submit SF 1080 billings and supporting cost and production reports to the JLSC for costs incurred/revenue recognized in FY93 by 23 Jul 93 and to continue to submit billings on a quarterly basis in the future. Cost and production reports are required in order for the JLSC to properly accumulate all developmental costs for eventual depreciation. If work on these projects was completed in FY92, we need to be apprised of this so that MIPRs can be amended and closed out.

4 We stand ready to answer questions on this matter and appreciate your immediate attention. Our point of contact for this is either Tim Brown or Dennis Kahn. JLSC/RMF, DSN 785-0350.

DALE L. PRICE
Deputy Director
Resource Management

1 Atch
DOD(C) Ltr. 21 Jan 92

OFFICIAL FILE COPY/RMF/T Brown/50350/18 Jun 93/cnk/revpnd24Jun:jaf/RMchanges/C tim:mprbtl

Joint Logistics Systems Center Comments



JOINT LOGISTICS SYSTEMS CENTER
WRIGHT-PATTERSON AIR FORCE BASE OHIO

15 JUN 1993

FROM: JLSC/CC
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

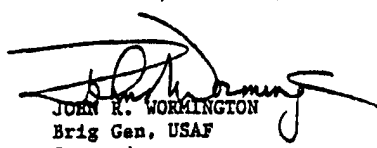
SUBJ: JLSC Capital Budget MIPR Billings

TO: Director, Defense Finance and Accounting Service
1931 Jefferson Davis Hwy, Room 400
Arlington VA 22240-2000

1. I am writing to ask your assistance in resolving a situation which is of utmost concern to the Joint Logistics Systems Center. Soon after the JLSC was deployed in March 1992, we began issuing reimbursable MIPRs on automated information system capital projects under our purview. Reimbursable MIPRs were issued per the OSD(C) Ltr, 1 Apr 92 (attached). This letter requires us to maintain separate sub-accounts for each line item in the Capital Budget and to accumulate costs by budget line item and project. The letter further requires the Components to bill the JLSC for authorized costs incurred in accordance with DOD revenue recognition policies.

2. In two subsequent JLSC letters, dated 7 Jul 92 and 8 Sep 92, we requested that the Components submit SF 1080 billings to the JLSC; we also have made this one of the requirements for acceptance of our capital MIPRs. It is imperative that the Components submit to us their billings, along with cost and production reports, so that the JLSC can properly accumulate all developmental costs by project for eventual depreciation. In spite of our requests, the majority of our billings to date have been through "cross-disbursing" on "by-other" cycles. To date, of the \$115M in billings received, \$66M, or 57% have been transmitted in this manner. This situation is unacceptable because it delays recording of project development costs into work-in-process sub-accounts. It also delays visibility to program execution and allows no review by JLSC prior to payment.

3. We request your influence and support in encouraging the Components to submit billings directly to us instead of "cross-disbursing" of our funds. Our point of contact for this is Tim Brown, JLSC/RMF, DSN 785-3030.


JOHN R. WORMINGTON
Brig Gen, USAF
Commander

1 Atch
OSD(C) Ltr, 1 Apr 92

cc: Maj Gen James R. Kighus (Ad)
Special ASD for Personnel
Pentagon Room 30964
Wash, D.C. 20301-1000

FROM: JLSC/RM

08 SEP 1992

SUBJ: Billing of FY 92 Incurred Costs

TO: MIPR Recipient

1. During the meeting held in Washington on 24 Apr 92, it was agreed by all components that they would prepare SF 1080 billings to cover costs incurred for the period 1 Oct 92 through 30 Apr 92 to comply with the guidance on revenue recognition. In our subsequent 7 Jul 92 letter to you, we noted that we had received no billings to date. In an attempt to clarify any confusion you may be experiencing with the financial procedures prescribed, we enclosed a package containing the most pertinent guidance on this process. As of this date, we have not received the billings requested for the time period above nor have we received any billings for the third quarter for funds sent to you on reimbursable MIPRs. Financial management guidance from the OSD Comptroller states that at a minimum the customer, which is JLSC, shall be billed and revenue recognized at the end of each fiscal year quarter.

2. As you know, a lack of recorded earnings gives the impression that no progress has been made in the implementation of the logistics CIM programs. Therefore, we must have information on your commitments, obligations and expenditures in order to assess the status of these program(s). In addition, please indicate the appropriation in which you have accepted the DBOF funding; e.g., O&M Reimbursable, Industrial Fund, etc. This data is due to us by 18 Sep 92 in the format attached to this letter. Any component which has obligational authority on a JLSC MIPR is subject to having the authority withdrawn if this information is not provided by the date requested.

3. This document does not replace the recurring requirement for SF 1080 billings as specified in the financial guidance.

SIGNED

DALE L. PRICE
Deputy Director
Resource Management

1 Atch
Format

Joint Logistics Systems Center Comments



JOINT LOGISTICS SYSTEMS CENTER

WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433

REPLY TO
ATTN: CPT

RMF

7 Jul 92

SUBJECT:

Billing of FY92 Incurred Costs

TO:

MPR Recipient

1. In the meeting held in Washington on 24 Apr 92, it was agreed by all components that SF 1080 billings would be prepared by the components covering costs incurred for the period 1 Oct 92 through 30 Apr 92 and submitted to JLSC for revenue recognition. As of this date we have not received the billings. It is important that these billings be recorded in order to ensure that your earnings are properly credited this fiscal year. A lack of recorded earnings gives the impression that no progress has been made in implementation of the Logistics CIM projects. It will be very difficult to defend proposed capital investment programs in the upcoming budget preparation drill if we can not show full execution of current year programs.

2. We are concerned that this situation may reflect confusion over the prescribed financial procedures. We fully recognize the difficulties involved in rapid implementation of such comprehensive financial changes in the way we do business. Attached is a package containing copies of the most pertinent guidance governing the process. We stand ready to answer questions or assist in any way we can.

3. We appreciate your giving this matter your full and immediate attention.

DALE L. PRICE
Deputy Director
Resource Management Directorate

3 Atch
1. 1 Apr 92 DoD(C) ltr
2. 21 Jan 92 DoD(C) ltr w/atc
3. 11 May 92 ASD(P&L/LS) ltr

WRIGHT-PATTERSON AIR FORCE BASE, OHIO 45433

MEMORANDUM FOR DFAS (MR. DAVID MOY)
THRU: ADUSD(LBS&TD) (MS. MARY ELLEN BEATTIE)

FROM: JLSC/ Building 15
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

**SUBJECT: Joint Logistics Systems Center (JLSC) Capital Budget MIPR Billings
(Your Memo, 29 Sep 93) - ACTION MEMORANDUM**

1. The JLSC continues to experience unacceptable delays in obtaining status information when MIPR billings flow through the cross-disbursement process. This issue was briefed to Mr. Richard Keevey, Principal Deputy, DOD Comptroller, as part of the JLSC execution review, 1 Mar 94.
2. In your memorandum, you proposed the paying and collecting offices for the JLSC development sites send the JLSC SF 1080 billings directly instead of using the cross-disbursing process. You suggested further, that for those who were unable to comply, the JLSC should, at a minimum, be sent a pre-billing before disbursement takes place. We are only receiving about 5% of our billings directly, and are not receiving any pre-billings for those processed through cross-disbursing.
3. We ask that you request all of our development sites' paying and collecting offices to send us a copy of the billing when cross-disbursements take place. In this manner, we will be able to record the current cost billed against each project, while not causing any excessive workload at the various accounting offices involved.
4. Thank you for your cooperation. Our point of contact is Dennis Kahn, JLSC/RMF, DSN 785-0405.

JOHN R. "JIM" JONES
Brig Gen USAF
Commander

Attachment
DFAS Memo. 29 Sep 93

ORIGINATOR FILE COPY/RMF/D Kahn/25 Feb 94/ljb/f:bills294



COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JAN 21 1992

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE COMMISSARY AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Revenue Recognition Policy For The Defense Business
Operations Fund

The current Department of Defense policy allows industrial fund activities to choose between two methods of revenue recognition: the completed-contract or percentage-of-completion methods. Operating results reported in the financial statements can vary considerably, depending upon which method is used. A recent General Accounting Office report stated, "In view of both the Chief Financial Officers Act of 1990 (Public Law 101-576) requirements that revolving funds undergo financial audits and the DoD integration of its industrial funds into the single Defense Business Operations Fund, it is especially important that all Fund entities use the same accounting principles" and "...generally accepted accounting principles require that income on long-term contracts be recognized in the period work is actually performed."

To ensure consistency in the revenue recognition policy for end-product type orders within DoD and to guarantee the operating results reported in the financial statements are comparable between business areas, the following DoD policy is effective immediately.

"The percentage-of-completion method of revenue recognition shall be used for all end-product type orders that are expected to be completed in a fiscal year other than the fiscal year in which the order is started. Revenue, under the percentage-of-completion method, may be recognized on a percentage of physical completion based on visual observation or judgment of qualified personnel. Alternatively, when costs are incurred on a relatively uniform basis over the life of an order, revenue may be recognized as a percentage of

incurred costs to total projected costs. In all instances, the portion of work in process associated with the revenue recognition shall be transferred to cost of goods sold. The customer funding the order shall be billed for the revenue recognized, or when progress payments have been previously billed, those progress payments shall be recorded to the appropriate revenue account. At a minimum, the customer shall be billed and revenue recognized at the end of each fiscal year quarter. In no case shall the total amount of revenue recognized and billed exceed the amount of the order."

Defense Business Operations Fund business areas, not currently using the percentage-of-completion method to recognize revenue will begin immediately to conform to this policy. Defense Business Operations Fund activities shall prepare their June 1992 financial statements using the percentage-of-completion method.

For service-type orders, revenue shall continue to be recognized at least monthly and considered as completed services rendered.

Please direct questions on this matter to Ms. Betty Pearson or Mr. John Glover, (703) 697-8282.

Donald B. Shycoff
Donald B. Shycoff
Principal Deputy Comptroller

Joint Logistics Systems Center Comments

FROM: JLSC/RM
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

SUBJ: Execution of the Revenue Recognition Policy (Your Ltr. 6 Apr.93)

TO: DOD(C)

1. We recognize the need to expedite cash collections into Defense Business Operations Fund (DBOF) so as to prevent any current shortfalls. However, we cannot agree with your desire to encourage our development activities who receive JLSC reimbursable authority to cross-disburse our funds. This situation is unacceptable as it delays recording of project development costs into our Work-in-Process account for eventual depreciation by the business area. Additionally, it delays visibility to program execution and allows no review by the JLSC functional directorates before payment. We have already expressed our concerns under separate cover concerning response to the DBOF FY93 Collection and Disbursement Plan.
2. Concerning any delays of funded orders, JLSC has not yet received all FY93 funding. Based on funding provided to us, however, we have executed the program in a prudent manner. We have not taken any action which would result in an unnecessary delay in executing our budget.
3. We have reiterated DBOF directed revenue recognition policy to all of our development activities and have no reason to believe they are not in compliance. It is difficult, if not impossible, however, to know if all of these activities are progress billing our account at least once a month. The abundance of billings are currently cross-disbursed and we have no visibility to them for as long as six months after payment.
4. We encourage you to make an exception for JLSC's developing activities and allow our local accounting and finance office to make all payments against our capital MIPRs. We have stated our problem to DFAS and hope to work with them to force this issue.

25 JAN 1994

FROM: JLSC/RMF, Bldg. 15
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

SUBJ: JLSC Requirement for a Cost Accounting System, Our Ltr, 23 Nov 93

TO: Defense Finance & Accounting Service
Deputy Director for Accounting
1931 Jefferson Davis Highway
Crystal Mall 3, Room 409
Arlington VA 22240-5291

1. We believe that our requirement to have access to a cost accounting system is essential to our mission. The need for this support is immediate. We had hoped that a standardized cost system would be chosen and permission for its use by the JLSC could have been granted by now. Because this has not happened, we wish to proceed with our own solution.

2. We have reviewed the Air Force Job Order Cost Accounting System (JOCAS II) and think it will satisfy our cost collection/allocation requirements. Our accounting support currently comes from the Air Force base level accounting system, and has proven successful when interfaced with JOCAS II. We will proceed with our plans to use JOCAS II and assume DFAS concurrence until hearing otherwise. Our points of contact are Dennis Kahn and Tim Brown, JLSC/RMF, DSN 785-0405.

SIGNED

SHERRY L. PARTEE
Chief, Financial Management Division
Resource Management Directorate

1 Atch
JLSC/RMF Ltr, 23 Nov 93

Joint Logistics Systems Center Comments

From: JLSC/RMF, Bldg. 15
1864 Fourth Street, Suite 1
Wright-Patterson AFB OH 45433-7131

23 NOV 1993

Subj: JLSC Requirement for a Cost Accounting System

To: Defense Finance & Accounting Service
Deputy Director for Accounting
1931 Jefferson Davis Highway
Crystal Mall 3, Room 409
Arlington VA 22240-5291

1. The notes to the JLSC's financial statements for both FY92 and FY93 disclosed that the JLSC is not in compliance with existing DOD and GAO Title 2 Accounting Standards due to the lack of a transaction driven general ledger. This has been a matter of great concern to the JLSC since its inception in March 1992. We believed that this problem would be corrected when the JLSC was directed to transfer to the Defense Business Management System (DBMS) in May 1993. This move was subsequently halted for an indefinite period. Since then, we have received no further guidance.
2. From a conversation with Mr. Glen Williams (DFAS-DE/ANBD), we understand that DFAS-HQ is considering placing the JLSC, and similar activities, on a cost accounting system, probably JOCAS II. We fully support such a transition to an acceptable cost accounting system of your choosing. This may enable us to properly apply our direct, indirect, and general and administrative costs to all capital projects under the purview of the JLSC.
3. Lastly, we would like to offer our assistance or input into your deliberations and planning for JLSC's possible transition. Our points of contact are Dennis Kahn and Tim Brown, JLSC/RMF, DSN 785-0406/7.

SIGNED

SHERRY L. PARTEE
Chief, Financial Management Division
Resource Management Directorate



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-8281

JUN 2 1994

DFAS-HQ/AD

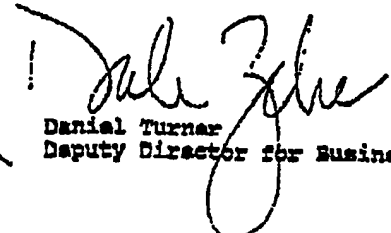
MEMORANDUM FOR DIRECTOR, LOGISTICS SUPPORT DIRECTORATE
INSPECTOR GENERAL, DOD

SUBJECT: DoDIG Draft Audit Report, "Joint Logistics Systems
Center's Financial Statements for FY 1993," (Project
No. 2LD-2021)

We have reviewed the subject draft report and have a management comment concerning recommendation 2. We concur, in principle, with the recommendation to revise the FY 1993 Financial Statements to show the effect of capitalizing assets, or at a minimum, disclose in footnotes to the revised statements the problems identified by the audit.

The Defense Finance and Accounting Service (DFAS) performs the accounting function and prepares the Chief Financial Officers Act financial statements for the Joint Logistics Systems Center (JLSC). The decision to capitalize assets must be made by JLSC. At the time the FY 1993 financial statements were published, JLSC had not directed the accounting entries for capitalization of assets. Since neither the audit report nor the management response to the audit were finalized prior to publication of the FY 1993 financial statements, DFAS could not include disclosure of problems identified by the audit. Any changes agreed to by JLSC will be incorporated in the FY 1994 statements. Estimated completion date: December 31, 1994.

My point of contact concerning this management comment is Mr. Ronal Boothe. He may be reached at (703) 607-1561/1578 or DSN 327-1561/1578.

for 
Daniel Turner
Deputy Director for Business Funds

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Part V - Additional Information

Appendix A. Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Under Secretary of Defense for Logistics, Washington, DC
Deputy Comptroller of the Department of Defense (Management Systems),
Washington, DC

Department of the Army

Assistant Secretary of the Army (Research, Development and Acquisition),
Fort Lee, VA
U.S. Army Depot System Command, Chambersburg, PA
Anniston Army Depot, Anniston, AL
Letterkenny Army Depot, Chambersburg, PA
Tobyhanna Army Depot, Tobyhanna, PA
Commander, Watervliet Arsenal, Watervliet, NY
U.S. Army Materiel Command, System Integration and Management Activity,
Chambersburg, PA
U.S. Army Strategic Logistics Agency, Alexandria, VA
U.S. Army Armament and Munitions and Chemical Command, Rock Island, IL
U.S. Army Missile Command, Redstone Arsenal, AL
Project Manager, Joint Computer-Aided Acquisition and Logistics Support, Fort
Monmouth, NJ
U.S. Army Procurement Research and Analysis Office, Fort Lee, VA

Department of the Navy

Naval Air Systems Command, Washington, DC
Naval Aviation Depot Norfolk, Norfolk, VA
Naval Sea Systems Command, Arlington, VA
Charleston Naval Shipyard, Charleston, SC
Norfolk Naval Shipyard, Norfolk, VA
Portsmouth Naval Shipyard, Portsmouth, NH
Naval Supply Systems Command, Arlington, VA
Navy Fleet Material Support Office, Mechanicsburg, PA
Navy Ships Parts Control Center, Mechanicsburg, PA
Headquarters, Naval Computer and Telecommunications Command, Washington, DC
Naval Computer and Telecommunications Station, Jacksonville, FL
Naval Computer and Telecommunications Station, New Orleans, LA
Naval Surface Warfare Center, Crane, IN
Naval Command, Control and Ocean Surveillance Center, San Diego, CA
U.S. Marine Corps Logistics Base, Albany, GA
Naval Information Technology Acquisition Center, Washington, DC

Department of the Air Force

Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Ogden Air Logistics Center, Hill Air Force Base, UT
Oklahoma City Air Logistics Center, Tinker Air Force Base, OK
Sacramento Air Logistics Center, McClellan Air Force Base, CA
San Antonio Air Logistics Center, Kelly Air Force Base, TX
Warner-Robins Air Logistics Center, Robins Air Force Base, GA

Defense Organizations

Headquarters, Defense Logistics Agency, Alexandria, VA
Joint Logistics Systems Center, Wright-Patterson Air Force Base, OH
Defense Logistics Agency Systems Automation Center, Columbus, OH
Defense Medical Support Activity, Falls Church, VA
Headquarters, Defense Finance and Accounting Service, Washington, DC
Defense Finance and Accounting Service-Columbus Center, Columbus, OH
Defense Finance and Accounting Service-Denver Center, Denver, CO
Defense Accounting Office, Wright-Patterson Air Force Base, OH
Defense Printing Service, Washington, DC

Non-Defense Organizations

Department of Energy, Richland Field Office, Richland, WA
General Accounting Office, Washington, D.C.

Appendix B. Report Distribution

Office of the Secretary of Defense

Comptroller of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Auditor General, Naval Audit Service

Department of the Air Force

Auditor General, Air Force Audit Agency

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange
Commander, Joint Logistics Systems Center

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
National Security and International Affairs Division, Technical Information Center
National Security and International Affairs Division, Defense and National
Aeronautics and Space Administration Management Issues
National Security and International Affairs Division, Military Operations and
Capabilities Issues

Non-Defense Federal Organizations (cont'd)

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

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**Part VI - Joint Logistics Systems Center
Financial Statements for FY
1993**

Joint Logistics Systems Center Financial Statements for FY 1993



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

MAR 15 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: Transmittal of U.S. Transportation Command and Joint Logistics Systems Center Financial Statements on FY 1993 Financial Activity

The attached financial statements for the U.S. Transportation Command, Business Operations Fund and Joint Logistics Systems Center, Business Operations Fund on FY 1993 financial activity are submitted for audit as required by the Chief Financial Officers Act.

My staff, and those of the U.S. Transportation Command and the Joint Logistics Systems Center, are available to provide assistance and information as you require in the audit of these financial statements. We will work with your staff to make the adjustments and improvements necessary.

My point of contact on this matter is Mr. Oscar G. Covell. He may be reached at (703) 697-6149 or DSN 227-6149.

A handwritten signature in cursive script, appearing to read "Alvin Tucker".

Alvin Tucker
Deputy Chief Financial Officer

Attachments

JOINT LOGISTICS SYSTEMS CENTER

FINANCIAL STATEMENTS
FOR FY 1993

**JOINT LOGISTICS SYSTEMS CENTER
OVERVIEW OF THE REPORTING ENTITY**

1. Message from the Component Head.

JLSC has had several important occurrences during the past year. Among the most important of these were the following.

- 13 Oct 93 OSD Memo
 - Directed accelerated implementation of Migration systems
 - Systems to be selected within six months
 - DOD-wide transition within three years
- 10 Oct 93 DUSD(L) and (C3I) Memo
 - Rescinded direction to transfer Central Design Activities (CDAs) to JLSC
- 24 Sep 93 DBOF Improvement Plan
 - Decision to move JLSC from DBOF to Appropriated funds in FY 95
- 20 Jul 93 DUSD(L) Memo
 - Rescinded DOD(A) direction 23 Nov 92 to place JLSC under DLA Director
 - JLSC to report directly to DUSD(L)
- 28 Jun 93 ASD(C3I) Memo
 - Direction to transfer Central Design Activities (CDAs) to JLSC
- 9 May 93
 - JLSC's transfer to Defense Business Management System (DBMS) terminated
- Mar 93
 - JLSC directed to transfer to the Defense Business Management System (DBMS)
- 6 Feb 93 DOD(C) Memo
 - Funding provided to implement JLSC's migration strategy
 - Initial Operating Site (IOS) designated for Materiel Management Standard System

2. Description of the Reporting Entity.

The JLSC was established by the ASD(P&L) Memorandum "Management of the Materiel Management Corporate Information Management (CIM) Initiative," 7 Nov 91. The JLSC mission is to achieve Corporate Information Management goals for the DOD logistics business area by managing the design, development, implementation of Automated Information Systems (AIS) and facilitating development and implementation of improved business practices. Four overall requirements and objectives of the JLSC were to:

- Facilitate business process improvements.
- Identify and justify specific process improvements and supporting AIS, if applicable.
- Manage the design, development, integration, implementation, and maintenance of the logistics process system.
- Ensure functional and technical integration.

Although JLSC is an activity within the DBOF, the JLSC does not have the typical customer-supplier relationships found with other business areas. The JLSC centrally procures CIM type investments for the Supply Management and Depot Maintenance business areas within the DBOF. The nature of JLSC's mission is such that it does not routinely sell a product or service to its customers in order to generate revenue to offset costs incurred in the development of software projects. The JLSC's ultimate customers are the functional activities within the Components who will use the JLSC-sponsored capital investments to provide goods and services to their customers. JLSC's costs will be recouped to the Defense Business Operations Fund (DBOF) when software projects under its purview are transferred to the Components and depreciation of these systems commences.

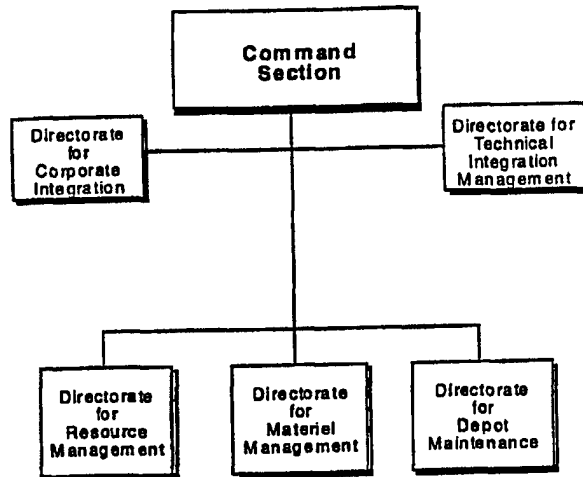
The JLSC's total Annual Operating Budget for FY93 was \$338.5M. The Annual Operating Budget was comprised of the Capital Budget (\$302.4M) and the Operating Budget (\$37.1M). The Operating Budget was used to fund the day-to-day operations of the JLSC. The Capital Budget was used to fund AIS development and implementations, business process improvements, and component mission unique requirements in two logistics business functional areas: Depot Maintenance (\$82.4M); Materiel Management (\$220.4M). Additionally, the JLSC had unused FY92 DBOF Capital Budget authority available to carry over into FY93 in the amount of \$121,266,515. The JLSC FY93 civilian workforce profile was as follows:

Direct	151
Indirect	46
G&A	53
Total	250

The JLSC funds automated information systems (AIS) and business process improvements for Supply Management and Depot Maintenance business areas with DBOF capital investment funds. As a result, the JLSC sponsors automated information systems development and modification initiatives which are performed by Central Design Activities (CDAs) or contractors. The JLSC issues reimbursable type funding orders to Component CDAs. Because most of the CDAs are in DBOF business areas, they are on Unit Cost Resourcing and Fee-for-Service, and are subject to the DBOF revenue recognition policies. Non-DBOF CDAs are also funded by JLSC on a cost reimbursable basis. JLSC maintains separate subaccounts for each capital project. JLSC and DBOF CDAs must agree on a fixed price for completing the specified work.

The JLSC operates as a joint center, with representation from the Army, Navy, Air Force, Marine Corps, and the Defense Logistics Agency (the Components). The JLSC's authority, scope, and funding are provided through DUSD(L). The JLSC financial and administrative procedures were derived from the Air Force's procedures. The JLSC, located at Wright-Patterson AFB OH is organized to efficiently perform its joint mission, roles and responsibilities. The basic JLSC organization is depicted below and consists of the following elements:

Joint Logistics Systems Center Financial Statements for FY 1993



- A Command Section
- A Corporate Integration Directorate to ensure the development of the logistics process system as a functionally and technically integrated system.
- A Technical Integration Management Directorate responsible for ensuring the logistics process system is developed as a technically integrated system.
- Two Functional Process Directorates responsible for improving the corporate logistics processes and managing the functional portion of the efforts required to design, develop, integrate, implement, maintain, and improve their portion of the logistics process system. Each functional directorate will develop and manage specific plans to meet its responsibilities towards achieving overall DUSD(L) policies and guidance, as well as goals and objectives and delivering the product to the customer. Currently functional directorates have been established for the business areas of Materiel Management and Depot Maintenance.
- The Resource Management Directorate responsible for coordinating requests for and managing funding, human and physical resources. JLSC/RM performs as the JLSC comptroller and coordinates JLSC performance measures and reporting.

3. Program Performance Measures: Not Applicable for FY92

4. Financial Performance Measures: Not Applicable for FY92

5. Financial Management Challenges.

The financial management issues, challenges, risks, and opportunities the JLSC will face

throughout the 1990s will center around how the JLSC will impact its customers in the DOD Components and other agencies with which it will interface. The JLSC centrally acquires capital assets on behalf of the DBOF's Supply Management and Depot Maintenance business areas. Most of the capital assets are acquired from Central Design Activities under contract with the JLSC. The JLSC performs its mission at the direction of the Under Secretary of Defense (Logistics). From a financial management perspective, the management and reporting requirements resulting from these organizational relationships will present challenges to the JLSC. A brief synopsis of the challenges are as follows:

- The JLSC will transfer ownership of the capital assets it centrally acquires to the DBOF business areas across the Components which will use the assets in their operations. The costs associated with acquiring the asset will be recovered by the DBOF through the depreciation expenses included in the business area's rates for its goods and services. The JLSC recognizes that the costs of the capital assets can directly affect the business area's cost performance and that in a workload competition environment, rates can be extremely sensitive. The JLSC, in conjunction with DOD(C), must determine a reasonable, fair and equitable method to derive the true cost of the capital asset and allocate the cost across those business areas which will receive the asset.
- The JLSC has relied on other DOD activities, specifically CDAs, to effectively and efficiently perform the work it sponsors. In FY94, JLSC plans to shift emphasis away from the CDAs and to issue funding directly to contractors to develop software for the JLSC. The JLSC has established customer-supplier type contractual relationships with the CDAs who will perform systems development and implementation work as specified by the JLSC. They must establish and implement procedures which will provide the management information needed to adequately control the CDA's cost, schedule and technical delivery performance. The procedures must provide the required information in a cost effective manner.
- The JLSC is accountable for its performance to its customer community, to the logistics functional managers in OSD, and to the DBOF managers in DOD(C). Financial performance measures must be established as a component of the JLSC's overall performance reporting to each of the constituents. Some of the measures may be the same, such as cost/benefits of JLSC delivered systems. Others will have more narrow scopes of interest, such as obligation and expenditure rates being of primary interest to the Comptroller community. The JLSC's challenge is in developing and implementing a process to efficiently and consistently measure and collect performance measurement information to support its reporting requirements.

Joint Logistics Systems Center Financial Statements for FY 1993

Department of the Air Force (as of 2/25/94)
 Defense Business Operations Fund - Joint Logistics Systems Center
 STATEMENT OF FINANCIAL POSITION
 As Of SEPTEMBER 30, 1993
 (In Dollars)

ASSETS	1993	1992
1. Financial Resources:		
a. Fund Balances with Treasury (Note 2)	(243,954,744)	(14,287,287)
b. Cash (Note 3)	0	0
c. Foreign Currency (Note 3)	0	0
d. Other Monetary Assets (Note 3)	0	0
e. Investments, Non-Federal (Note 4)	0	0
f. Accounts Receivable, Net - Non-Federal	0	0
g. Inventories Held for Sale, Net (Note 5)	0	0
h. Loans Receivable, Net - Non-Federal (Note 6)	0	0
i. Property Held for Sale (Note 7)	0	0
j. Other, Non-Federal (Note 8)	0	0
k. Intragovernmental Items:		
(1) Accounts Receivable, Federal	404,736	7,667,156
(2) Loans Receivable, Federal	0	0
(3) Investments, Federal (Note 4)	0	0
(4) Other, Federal	0	16,364,548
l. Total Financial Resources	(243,550,008)	9,744,418
2. Non-Financial Resources:		
a. Resources Transferable to Treasury	0	0
b. Advances and Prepayments, Non-Federal	0	0
c. Inventories Not Held for Sale (Note 5)	0	0
d. Property, Plant and Equipment, Net (Note 9)	266,392,049	0
e. Other (Note 10)	0	0
f. Total Non-Financial Resources	266,392,049	0
3. Total Assets	22,842,041	9,744,418

The accompanying notes are an integral part of these statements.

Joint Logistics Systems Center Financial Statements for FY 1993

LIABILITIES	1993	1992
4. Funded Liabilities:		
a. Accounts Payable, Non-Federal	0	0
b. Accrued Interest Payable	0	0
c. Accrued Payroll and Benefits	2,457,000	0
d. Accrued Entitlement Benefits	0	0
e. Lease Liabilities (Note 11)	0	0
f. Liabilities for Loan Guarantees (Note 6)	0	0
g. Deferred Revenue - Non-Federal	0	0
h. Pensions and Other Actuarial Liabilities (Note 14)	0	0
i. Other Funded Liabilities, Non-Federal (Note 13)	0	0
j. Intragovernment Liabilities		
(1) Accounts Payable, Federal	32,895,589	6,940,048
(2) Debt (Note 12)	0	0
(3) Deferred Revenue	0	0
(4) Other Funded Liabilities, Federal (Note 13)	0	0
k. Total Funded Liabilities	35,352,589	6,940,048
5. Unfunded Liabilities:		
a. Accrued Leave	0	0
b. Lease Liabilities (Note 11)	0	0
c. Debt (Note 12)	0	0
d. Pensions and Other Actuarial Liabilities (Note 14)	0	0
e. Other Unfunded Liabilities (Note 15)	0	0
f. Total Unfunded Liabilities	0	0
6. Total Liabilities	35,352,589	6,940,048
NET POSITION		
7. Fund Balances: (Note 16)		
a. Revolving Fund Balances	(12,510,548)	2,804,372
b. Trust Fund Balances	0	0
c. Appropriated Fund Balances	0	0
d. Total Fund Balances	(12,510,548)	2,804,372
8. Less Future Funding Requirements (Note 17)	0	0
9. Net Position	(12,510,548)	2,804,372
10. Total Liabilities and Net Position	22,842,041	9,744,418

The accompanying notes are an integral part of these statements.

Joint Logistics Systems Center Financial Statements for FY 1993

Department of the Air Force
 Defense Business Operations Fund - Joint Logistics Systems Center
 STATEMENT OF OPERATIONS (AND CHANGES IN NET POSITION)
 FOR THE PERIOD ENDED SEPTEMBER 30, 1993
 (In Dollars)

	1993	1992
REVENUES AND FINANCING SOURCES		
1. Appropriations Expensed	0	0
2. Revenues from Sales of Goods		
a. To the Public	0	0
b. Intragovernmental	35,434	10,100,000
3. Interest and Penalties, Non-Federal	0	0
4. Interest, Federal	0	0
5. Taxes (Note 18)	0	0
6. Other Revenues and Financing Sources (Note 19)	0	0
7. Less Taxes and Receipts Returned to the Treasury	0	0
8. Total Revenues and Financing Sources	35,434	10,100,000
EXPENSES		
9. Program or Operating Expenses (Note 20)	0	0
10. Cost of Goods or Services Sold (Note 21)		
a. To the Public	0	0
b. Intragovernmental	29,637,640	7,295,628
11. Depreciation and Amortization	0	0
12. Bad Debts and Writeoffs	0	0
13. Interest		
a. Federal Financing Bank/Treasury Borrowing	0	0
b. Federal Securities	0	0
c. Other	0	0
14. Other Expenses (Note 22)	0	0
15. Total Expenses	29,637,640	7,295,628
16. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses Before Adjustments	(29,602,206)	2,804,372
17. Plus (Minus) Adjustments:		
a. Extraordinary Items (Note 23)	0	0
b. Prior Period Adjustments (Note 23)	0	0
18. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(29,602,206)	2,804,372
19. Plus: Unfunded Expenses	0	0
20. Excess (Shortage) of Revenues and Financing Sources Over Funded Expenses	(29,602,206)	2,804,372
21. Net Position, Beginning Balance	2,804,372	0
22. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(29,602,206)	2,804,372
23. Plus (Minus) Equity Transfers (Note 24)	14,287,287	0
24. Net Position, Ending Balance	(12,510,548)	2,804,372

The accompanying notes are an integral part of these statements.

Joint Logistics Systems Center Financial Statements for FY 1993

Department of the Air Force
 Defense Business Operations Fund - Joint Logistics Systems Center
 STATEMENT OF CASH FLOWS
 FOR THE PERIOD ENDED SEPTEMBER 30, 1993
 (In Dollars)

	1993	1992
Cash Flows from Operating Activities		
1. Excess (Shortage) of Revenues and Financing Sources Over Total Expenses	(29,602,206)	2,804,372
Adjustments Affecting Cash Flow:		
2. Appropriations Expensed	0	0
3. Decrease (Increase) in Accounts Receivable	7,282,421	(7,667,156)
4. Decrease (Increase) in Loans Receivable	0	0
5. Decrease (Increase) in Other Assets	16,364,548	(16,364,548)
6. Increase (Decrease) in Accounts Payable	25,955,543	6,940,046
7. Increase (Decrease) in Other Liabilities	2,457,000	0
8. Depreciation and Amortization	0	0
9. Other Unfunded Expenses	0	0
10. Other Adjustments	0	0
11. Total Adjustments	52,039,511	(17,091,658)
12. Net Cash Provided (Used) by Operating Activities	22,437,305	(14,287,287)
Cash Flows from Non-Operating Activities		
13. Proceeds from Sales of Investments	0	0
14. Proceeds from Sales of Property, Plant and Equipment	0	0
15. Purchases of Investments	0	0
16. Purchases of Property, Plant and Equipment	266,392,049	0
17. Net Cash Provided (Used) by Non-Operating Activities	(266,392,049)	0

The accompanying notes are an integral part of these statements.

Joint Logistics Systems Center Financial Statements for FY 1993

CASH PROVIDED (USED) BY FINANCIAL ACTIVITIES		
	1993	1992
18. Appropriations (Current Warrants)	0	0
19. Add:		
a. Restorations	0	0
b. Transfers of Cash from Others	14,287,287	0
20. Deduct:		
a. Withdrawals	0	0
b. Transfers of Cash to Others	0	0
21. Net Appropriations	14,287,287	0
22. Borrowing from the public	0	0
23. Repayments on Loans to the Public	0	0
24. Borrowing from the Treasury and the Federal Financing Bank	0	0
25. Repayments on Loans from the Treasury and the Federal Financing Bank	0	0
26. Other Borrowings and Repayments	0	0
27. Net Cash Provided (Used) by Financing Activities	14,287,287	0
28. Net Cash Provided (Used) by Operating, Non-Operating and Financing Activities	(229,667,457)	(14,287,287)
29. Fund Balance with U.S. Treasury, Cash and Foreign Currency, Beginning	(14,287,287)	0
30. Fund Balance with U.S. Treasury, Cash and Foreign Currency, Ending	(243,954,744)	(14,287,287)
Supplemental Disclosure of Cash Flow Information:		
31. Total Interest Paid	0	0
Supplemental Schedule of Financing and Investing Activity:		
32. Property and Equipment Acquired Under Capital Lease Obligations	0	0
33. Property Acquired Under Long-term Financing Arrangements	0	0
34. Other Exchanges of Noncash Assets or Liabilities	0	0
The accompanying notes are an integral part of these statements.		

Joint Logistics Systems Center Financial Statements for FY 1993

Department of the Air Force
 Defense Business Operations Fund - Joint Logistics Systems Center
STATEMENT OF BUDGET AND ACTUAL EXPENSES
FOR THE PERIOD ENDED SEPTEMBER 30, 1993
 (In Dollars)

Program Name (s)	BUDGET	ACTUAL
Resources	Obligations	Expenses
	Direct	Reimbursed
Joint Logistics Systems Center	457,874,408	0
	440,179,374	29,637,640
Totals	457,874,408	0
	440,179,374	29,637,640
 <u>Budget Reconciliation:</u>		
A. Total Expenses		29,637,640
B. Add:		
(1) Capital Acquisitions		266,392,049
(2) Loans Disbursed		0
(3) Other Expended Budget Authority		0
C. Less:		
(1) Depreciation and Amortization		0
(2) Unfunded Annual Leave Expenses		0
(3) Other Unfunded Expenses		13,907,547
D. Expended Appropriations		282,122,142
E. Less Reimbursements		35,434
F. Expended Appropriations, Direct		282,086,708

The accompanying notes are an integral part of these statements.

Joint Logistics Systems Center Financial Statements for FY 1993

NOTES TO THE FINANCIAL STATEMENTS FOR THE JOINT LOGISTICS SYSTEMS CENTER FY 93

Note 1: Summary of Significant Accounting Policies:

A. Reporting Entity and Basis of Consolidation:

The Assistant Secretary of Defense for Production and Logistics (ASD(P&L)), directed that a Joint Logistics Systems Center (JLSC) be established effective December 31, 1991. The JLSC was established to implement integrated business process improvements by managing the development, integration, implementation and maintenance of the logistics areas of the Corporate Information Management (CIM) effort for Depot Maintenance and Supply Management.

The JLSC mission requires that it take a central role in the logistics functional area. The JLSC will facilitate, in conjunction with the functional communities, the identification of corporate business process improvements, and the appropriate application of Automated Information Systems (AIS) and related technologies to maximize operational effectiveness and achieve cost savings. The JLSC will employ data standardization to support corporate logistics systems design, development, integration, implementation and maintenance.

The trial balance reports are manually prepared at 645 ABW/FM, Wright Patterson AFB, Ohio for the JLSC. The accompanying consolidated financial statements of the JLSC include the fund balance with Treasury of \$(243,954,744).

The Defense Finance and Accounting Service - Denver Center uses the Departmental OnLine Accounting and Reporting System (DOLARS) to consolidate and prepare JLSC's financial reports. DOLARS uses an Air Force unique general ledger structure.

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

B. Accounting Standards:

The financial statements are presented in accordance with the accounting principles and reporting standards contained in the Department of Defense (DoD) Accounting Manual (DoD 7220.9-M). The following are areas in which JLSC does not currently comply with existing DoD accounting standards:

(1) Chart of Accounts. JLSC has not implemented the standard DoD General Ledger chart of accounts.

(2) General Ledger. JLSC has not implemented a true transactions driven general ledger system to provide a consolidated source of financial management information for either management or financial statement purposes.

C. Basis of Accounting:

Transactions are recorded on the accrual basis of accounting as required by the DoD Accounting Manual. Under the accrual basis, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt for payment of cash. All interfund balances and transactions have been eliminated.

Presently, JLSC funds are accounted for as a DoD corporate fund using an Air Force stock fund chart of accounts. However, JLSC does not sell merchandise as do stock fund business activities. The JLSC's cost will not be recouped to the Defense Business Operations Fund (DBOF) until software projects managed by the JLSC are turned over to the components and depreciation of these system commences.

D. Business Area Policy and Procedures:

Operations of the business areas are based on the policies and procedures that have been in effect for the stock and industrial funds. However, a number of management, accounting, policy, and procedural changes were implemented. These include:

(1) Under a new policy, business budgets are segregated into operating and capital budgets. Any investment in

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

equipment, software, minor construction, and other management improvements costing more than \$15,000 will be funded through the capital budget and depreciated over its relevant life cycle.

(2) The JLSC sets its pricing rates based on full cost recovery. This ensures that cost reductions made by JLSC will be passed along to customers. Prices are not changed during the year of execution.

(3) Under the auspices of DoD and the federal government, the JLSC interacts with and is dependent on the financial activities of the federal government as a whole. Therefore, these financial statements do not reflect the results of all financial decisions applicable to the JLSC as though it were a stand-alone entity.

E. Revenues and Other Financing Sources: The JLSC received a total FY 92 Annual Operating Budget of \$425,300,000. The operating budget is \$21,200,000 and the capital budget is \$404,100,000. The operating budget was received in two parts. The first \$10,100,000 was received from the Uniformed Services and the Defense Logistics Agency (DLA) as reimbursable Military Interservice Purchase Requests (MIPRs) for initial start-up costs, on a one time basis only. Accounting for the reimbursable portion is in keeping with guidance from DoD(C), memorandum dated February 25, 1992. The entire \$10,100,000 was completely billed to the Uniform Services and DLA as of June 1993. All subsequent funding for the operating budget and the capital budget was provided to the JLSC in obligation authority from the DBOF corpus. In FY 93, the JLSC received \$37,100,000 in operating budget authority and \$302,400,000 in capital budget authority.

F. Accounting for Intra-governmental Activities: Reference Note E, and Note 26.

G. Accounts Receivable: As presented in the Consolidated Statement of Financial Position, accounts receivable include reimbursements receivable. During FY 93, the JLSC had federal accounts receivable of \$404,736, no non-federal accounts receivable, and no allowances for doubtful accounts. Reference Note 25.(A).

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

H. Other Federal Financial Resources: The FY 92 JLSC trial balance recorded \$16,364,548 of capital expenditures in progress billings (reference line 1.k.(4) of the Statement of Financial Position). In FY 93, a Property, Plant, & Equipment account was established to include all software development costs. The \$16,364,548 was transferred to this account. Reference Note 1.(I). The FY 93 balance for line 1.k.(4) of the Statement of Financial Position is -0-.

I. Property and Equipment: In FY 93, a Property, Plant, & Equipment account was established to include all software development cost. This account includes \$16,364,548 of cost incurred in FY 92, and \$250,027,501 of cost incurred in FY 93. Of the \$250,027,501, \$123,000,000 was disbursed in FY 93.

J. Accounts Payable, Federal: The balance is \$32,895,589. The increase of \$25,955,543 in Accounts Payable in FY 93 is due to the fact that the JLSC was in operation for a full year in FY 93, and only one-half year in FY 92. Refer to line 4.j.(1) of the Statement of Financial Position, and line 6 of the Statement of Cash Flows.

K. Comparative Data: Comparative data are provided for FY 92, and FY 93 to provide an understanding of changes in financial position and operations of the JLSC.

Note 2. Fund Balances with Treasury, Cash, etc.:

A. The JLSC does not maintain cash in commercial bank accounts. All DBOF cash balances are maintained at the corporate level, and not at each business level. Cash receipts and disbursements are processed by the U.S. Treasury. The fund balance with the Treasury is \$(243,954,744). The balances for cash and foreign currency are -0-.

B. Other Information: The negative fund balance results because the JLSC disburses capital budget funds against development projects which will not be recouped to the DBOF until software is transferred to the Uniformed Services, and DLA and depreciation begins.

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

Joint Logistics Systems Center Financial Statements for FY 1993

Note 3. Other Monetary Assets: There were no transactions or balances reported.

Note 4. Investments: No transactions or balances reported.

Note 5. Inventories: No transactions or balances reported.

Note 6. Loans and Loan Guarantees, Non-Federal: There were no transactions or balances reported.

Note 7. Property Held for Sale: There were no transactions or balances reported.

Note 8. Other Financial Resources - Non-Federal: There were no transactions or balances reported.

Note 9. Property, Plant, and Equipment, Net:

	<u>Acquisition Value</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
ADP Software	\$266,392,049	000	\$266,392,049
Total	\$266,392,049 =====	000 ---	\$266,392,049 =====

ADP Software is not depreciated by JLSC. It is depreciated by the agency acquiring the software. JLSC does not own land, buildings or equipment. See Notes 1.(H) and 1.(I).

Note 10. Other Non-Financial Resources: There were no transactions or balances reported.

Note 11. Leases: No transactions or balances reported.

Note 12. Debt: The JLSC reported no debt liability. The JLSC's proportionate share of public debt and related expenses of the federal government are not included in the financial statements. Debt incurred by the federal government and related interest are not apportioned to federal agencies. Consequently, JLSC's financial statements do not reflect any portion of the public debt or interest thereon, nor do the

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

Joint Logistics Systems Center Financial Statements for FY 1993

statements reflect the source of public financing.

Note 13. Other Funded Liabilities: There were no transactions or balances reported.

Note 14. Pensions and Other Actuarial Liabilities: This business area's civilian employees participate in the Civil Service Retirement System (CSRS), Federal Employee Retirement System (FERS), and Thrift Savings Plan (TSP), while military personnel are covered by the Military Retirement System (MRS). Additionally, employees and personnel covered by FERS and MRS are also covered by Social Security. JLSC finances a portion of pension benefits under these retirement systems but does not disclose the assets or actuarial data on the accumulated plan benefits or unfunded liabilities of their employees. Reporting of these amounts is the responsibility of the Office of Personnel Management for CSRS, FERS, and TSP, and DoD for MRS.

Note 15. Other Unfunded Liabilities: There were no transactions or balances reported.

Note 16. Fund Balances:

	<u>Revolving Funds</u>	<u>Trust Funds</u>	<u>Appro- priated Funds</u>	<u>Total</u>
A. Unexpended Appropriations	000	000	000	000
B. Invested Capital	000	000	000	000
C. Cumulative Results of Operations	\$(12,510,548)	000	000	\$(12,510,548)
D. Donations	000	000	000	000
E. Transfers	000	000	000	000
F. Total	<u>\$(12,510,548)</u>	<u>000</u>	<u>000</u>	<u>\$(12,510,548)</u>

JLSC did not report unexpended appropriations, invested capital, donations or transfers. Cumulative results of operations for the JLSC fund represent the excess of expenses over revenues since fund inception. JLSC had a cumulative results of operations in FY 92 of \$2,804,372. This was related

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

Joint Logistics Systems Center Financial Statements for FY 1993

to revenue generated by the receipt of \$10,100,000 in reimbursable MIPRs provided by the Uniformed Services and DLA as a one-time start-up cost.

In FY 93 and subsequent years, JLSC will have negative results of operations due to the nature of its mission. The JLSC does not provide goods or services for which it is routinely reimbursed. Rather, JLSC's operating and capital costs will be reimbursed to the DBOF when depreciation commences on software projects managed by the JLSC.

Note 17. Future Funding Requirements: No transactions or balances reported.

Note 18. Taxes: No transactions or balances reported.

Note 19. Other Revenue and Financing Sources: No transactions or balances reported.

Note 20. Program or Operating Expenses: No transactions or balances reported.

Note 21. Cost of Goods Sold:

A. Cost of Services Sold

(1) Beginning Work-in-Process	000
(2) Plus: Operating Expenses	\$29,637,640
(3) Minus: Ending Work-in-Process	000
(4) Minus: Completed Work for Activity Retention	000
Cost of Services Sold	\$29,637,640

B. This is an increase of \$22,342,012 over FY 92's total of \$7,295,628. The reason for this increase is that the JLSC was in existence for only one-half year in FY 92 and for an entire year in FY 93. Since the JLSC was not established until March 1992, FY 92 personnel and administrative costs were very low because few employees were on board initially. These costs increased in FY 93 as additional staff was brought on board.

Note 22. Other Expenses: There were no transactions or balances reported.

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

Joint Logistics Systems Center Financial Statements for FY 1993

Note 23. Extraordinary Items and Prior Period Adjustments:
There were no adjustments made to the financial statements.

Note 24. Transfers (and Donations): Equity transfers amounted to \$14,287,287.

Note 25. Other Statement of Financial Position Notes:

A. The Accounts Receivable, Federal, balance as of September 30, 1993 is \$404,736; a decrease \$7,262,421 from FY 92. The \$404,736 represents the outstanding portion of the \$10,100,000 received from the Uniformed Services and DLA as start-up cost for the JLSC in FY 92. The JLSC had no additional accounts receivables in FY 93.

B. The Accrued Payroll and Benefits balance of \$2,457,000 is for compensation for military personnel assigned to the JLSC.

Note 26. Other Statement of Operations Notes: Revenues of \$35,434 reflected in the Sales of Goods, Intragovernmental, are a duplicate payment received from DLA on its share of the \$10,100,000 in FY 92 start-up costs for JLSC. The error is not material enough to amend the FY 93 financial statements; this error will be corrected in FY 94.

Note 27. Statement of Budget and Actual Expenses Notes:

A. Resources: The balance of \$457,874,408 is in agreement with the September 30, 1993 DD Form 1176, line 3.

B. Obligations: The balance of \$440,179,374 is in agreement with the September 30, 1993 DD Form 1176, line 7.

C. Expended Appropriations, Direct: The balance of \$282,086,708 is in agreement with the DD Form 1176, line 16.

These Notes to the Financial Statements of the JLSC are an integral part of the statements. See Defense Finance and Accounting Service - Denver Center transmittal memorandum, dated March 4, 1994, for additional information.

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